Managing the Debt Portfolio
Debt Policy Objectives

a) Maintaining access to financial markets: capital, money, and bank markets.

b) Managing the System’s credit rating (if applicable) to meet its strategic objectives while maintaining the highest possible creditworthiness that provides the most favorable cost of capital and borrowing terms;

c) Optimizing the System’s debt mix (i.e., short-term and long-term, fixed-rate, and floating-rate, traditional, and synthetic) for the System’s debt portfolio;

d) Managing the structure and maturity profile of debt to meet liquidity objectives and to make funds available to support future capital projects and strategic initiatives;

e) Coordinating debt management decisions with asset management decisions to optimize overall funding and portfolio management strategies;

f) Coordinating debt management decisions to maximize overall access to resources, including consideration of strategic opportunity costs, potential lost revenue, and interest and inflation rate tradeoffs.
OUS Debt Portfolio Management Approach

• Includes elements from popular management styles
  – Asset Liability Management
    • Assets = Loans to campuses
    • Liabilities = Debt payable to bondholders
    • Cash from operations is selectively used to provide interim funding and short-term funding through the internal loan policy
  – Traditional Portfolio Management
    • Traditional buy and hold (for debt portfolio “issue and pay”)
    • Refinance when it makes sense
  – Benchmark (new)
    • Identify a particular index or benchmark
    • Accept certain risks for a fraction of the portfolio (probably 15-30%)
      – Natural or synthetic instruments to affect duration
      – Issue at terms to improve spreads (calls, puts, covenants, etc.)
Portfolio Management

– Optimizing the System’s debt mix is all about managing the expense
  • Strategies to provide a stable long-term cost of capital
  • Strategies to reduce the long-term cost of capital
Techniques for Stable Cost of Capital

• View debt as a portfolio
• Enter the market regularly
  – Works like dollar cost averaging
  – No need to time the market
  – Strategy works better the longer your portfolio
• Always issue debt in the same structure
  – Fixed rate
  – Level debt service
  – Issue the same amount each time
Techniques to Reduce Cost

• Refinance debt when feasible (little risk)
• Manage portfolio “duration”
  – Shorten the portfolio
    • Float cost off a shorter term index
    • Issue shorter term debt than needed
    • Can achieve with synthetic agreements
  – Lengthen the portfolio
    • Issue bullets instead of serializing debt
    • Issue longer term debt than needed
    • Can achieve with synthetic agreements
SO...
SHOULD WE SHORTEN OR LENGTHEN?
Treasury Curve
Current Curves

- Not always consistent with Treasury curve
  - 30-yr MMD is currently more than 106% of Treasuries
  - Average is 98%
• Strategy needs to react to
  – Expected changes in interest rate (shifts)
  – Expected changes in the yield curve (shape)

• Conventional wisdom is simple
  – Shorten when steep
  – Lengthen when flat
Rate Environment Quadrants
Fixed Rate vs. Floating Rate
7/1/1989 through 3/17/2011

I: Low Fixed Rates, Steep Yield Curve
You were here on 03/17/11
5/13/10

II: High Fixed Rates, Steep Yield Curve
SNW recommends: Stay short

III: Low Fixed Rates, Flat Yield Curve
SNW recommends: Issue long, fill in short later if needed

IV: High Fixed Rates, Flat Yield Curve
Should We Shorten or Lengthen?

• Environment
  – Relatively high long-term rates
  – Near historic levels of steepness

• Conclusion
  – Issuing debt in today’s rate environment will probably have no material impact on the overall cost of capital (stabilizing effect)
  – Good opportunity to shorten a portion of the portfolio to reduce cost
Techniques to Shorten the Portfolio

• Float cost off a shorter term index
• Issue fixed rate debt but issue for shorter terms than needed
• Can achieve with synthetic agreements

Caveat:
Active portfolio management comes with additional transaction costs and interest cost volatility. Like our refunding policy, we will want to set parameters for a minimum acceptable expected savings and a maximum for interest cost volatility.
Next Meeting

• Written strategy for current rate quadrant
  – Take into account today’s feedback regarding
  – Identify parameters for the various “tools”
    • Benchmarks, if possible
    • Percentage of portfolio used to reduce cost
    • Identify target “duration,” if possible
  – Implementation Plan
  – Policy changes needed to implement the strategy